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Supreme Court of the United States

OCTOBER TERM, 1963

No. [redacted] 142

GENERAL AGGREGATES CORPORATION,
PETITIONER,

v.

COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

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Blanchard Printing Company, Boston, Mass. — Law Printers

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COMMISSIONER OF INTERNAL REVENUE,
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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the First Circuit entered in the above-entitled case on January 31, 1963.

Opinions Below

The opinion of the Tax Court of the United States (R. 110-126) is reported in T. C. Memo 1962-27. The opinion of the Court of Appeals for the First Circuit, printed in Appendix A hereto, infra, pp. 14-20, is reported in 313 F. (2d) 25.

Jurisdiction

The judgment of the Court of Appeals for the First Circuit was entered on January 31, 1963 (R. 148) and is printed in Appendix B hereto, infra p. 21. A petition for rehearing was denied on February 19, 1963 (R. 170). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

Questions Presented

A corporation advanced sums of money partly to petitioner, which was its parent, and partly to one Wilbur, the principal executive officer of both corporations. The respondent determined that all the sums so advanced constituted dividends to petitioner and subjected petitioner to liability for income tax and for the personal holding company surtax. The Tax Court affirmed the respondent's determination. The Court of Appeals held that some, but not all, of the payments were dividends and remanded the action to the Tax Court for a new decision consistent with the decision of the Court of Appeals.

The questions presented for review are:

(1) Whether in reviewing a determination that certain payments received by a taxpayer were to be treated as dividends, thus subjecting it to liability for the personal holding company surtax, a court should give consideration to the nature and purpose of the personal holding company surtax.

(2) Whether in a case involving liability for personal holding company surtax the burden of proof lies on the taxpayer or on the Commissioner of Internal Revenue.

(3) Whether in a case where the taxpayer introduces evidence, and the Court finds, that the Commissioner's determination of tax liability was invalid to a substantial

extent, the burden of proving the existence and amount of the deficiency rests on the Commissioner.

(4) Whether a ruling by the Tax Court that certain payments should be treated as dividends is a question of law (or mixed fact and law) on which a Court of Appeals may substitute its judgment for that of the Tax Court.

Statutes Involved

The statutory provisions involved are the following sections of the Internal Revenue Code of 1939:

Sec. 500, (26 U.S.C. 1952 ed., sec. 500)
Sec. 501(a)(1), (26 U.S.C. 1952 ed., sec. 501(a)(1))
Sec. 502(a), (26 U.S.C. 1952 ed., sec. 502(a))

They are printed in Appendix C, infra, p. 22.

Statement

Petitioner, a Massachusetts corporation, owned all the common stock of Highland Sand & Gravel Company, Inc. ("Highland"). Both corporations were dominated by their chief executive officer, George S. Wilbur, who with members of his family were the principal stockholders of petitioner. (R. 112, 125). In addition Highland had outstanding cumulative preferred stock on which there were substantial dividend arrearages. Part of this stock was owned by persons unrelated to Wilbur.

Wilbur decided to construct and operate a "high-class restaurant" in Beverly, Massachusetts, on property which he personally leased from the owners (R. 112) and organized a corporation Chateau Montserrat, Inc. ("Chateau") for the purpose of conducting the restaurant venture. Chateau never issued any stock certificates (R. 113) but the Tax Court found that the petitioner owned 50% of the Chateau stock (R. 122). The Tax Court made no finding as

to the ownership of the remaining 50%; the Court of Appeals impliedly at least held that Wilbur's former secretary owned the balance of the stock either beneficially or as a nominee for Wilbur. (Appendix A, pp. 16-17)

The fitting out of the Chateau restaurant required substantial sums of money. Part of the necessary funds came direct from petitioner's treasury, but the bulk of the funds, approximately $125,000, was derived from Highland. (Appendix A, p. 16). To obtain these funds Wilbur caused Highland to advance to petitioner sums aggregating $98,500 in 1951 and 1952. (R. 122) These advances were shown on the books of both corporations as loans from Highland to petitioner. (R. 113, 117) As the money was received by petitioner it was almost immediately paid out either to Chateau or to vendors supplying equipment or services to the restaurant. (R. 113-115, 117-118) The Court of Appeals found that these payments by petitioner were loans to Chateau. (Appendix A, p. 20, footnote 5)

Wilbur obtained additional funds for the restaurant venture by causing Highland to pay to him $27,635.04, which he in turn used immediately for Chateau. (R. 115, 119).

The restaurant opened in 1951. The business lost money and closed in 1952 shortly after Wilbur's death. It was then liquidated by public auction for about $1,400 net. (R. 121). Neither the loans made to Chateau nor the advances made by Highland to petitioner and Wilbur were ever repaid.

Shortly after Wilbur's death the remaining directors of petitioner learned for the first time that Wilbur had organized the Chateau venture (R. 113, 79, 106), although it does not appear from the record when they acquired detailed knowledge of the transactions by which the restaurant corporation was financed.

Respondent determined that all the advances made by Highland to petitioner and to Wilbur constituted dividends, and hence personal holding company income to petitioner.

(R. 9) (It is conceded that petitioner met the stock ownership requirements of a personal holding company.) Respondent accordingly asserted against petitioner for the years 1951 and 1952 deficiencies in income tax aggregating $5,428.54 and deficiencies in personal holding company surtax aggregating $100,657.75. (R. 9, 127)

In its petition to the Tax Court petitioner asserted that the advances made by Highland were loans or in any event did not constitute personal holding company income. (R.) The Tax Court in sustaining respondent's determination ruled only on the question as to whether the advances were loans. (R. 122) In holding that the advances were not loans, the court stressed the fact that the advances had not been repaid, (R. 124) a circumstance which in the court's view showed lack of an intention to repay. Having ruled that the advances were not loans, the court concluded that they were dividends. (R. 126). (Appendix A, p. 17)

On the petition to review the Tax Court's decision, the Court of Appeals distinguished between the advances made by Highland directly to petitioner aggregating $98,500 and those made to Wilbur aggregating $27,635.04 and held that the latter payments were not dividends to petitioner. (Appendix A, p. 20) With reference to the former payments the Court accepted the Tax Court's ruling that they were not loans, stating that "the [Tax] Court was [not] plainly wrong". (Appendix A, p. 18). The Court's opinion, however, made no reference whatsoever to the personal holding company surtax and thus in effect held that liability for the penalty surtax and liability for income tax are to be measured by identical considerations.[1] The Court also assumed

[1] Petitioner called this omission to the court's attention in point IV of its petition for rehearing (R. 165). The Court may reasonably infer that petitioner had at earlier stages in the proceedings urged both the Tax Court and the Court of Appeals to consider the nature of the personal holding company surtax in arriving at their decisions.

(erroneously in the view of petitioner) that the only issue before it was whether the advances were loans and ignored the basic issue, that is, whether the advances were personal holding income, i.e. dividends to petitioner.[2]

Reasons for Granting the Writ

1. The decision below should be reviewed because the Court's failure to take into consideration the penalty nature and purpose of the personal holding company surtax indicates that the case is in direct conflict with the decision of the Court of Appeals for the Second Circuit in *Frelbro* v. *Commissioner*, decided on April 1, 1963.[3]

In *Frelbro* a subsidiary corporation which owed money to its parent, including an amount credited to dividends, paid this amount together with a dividend for the current year to the parent. The parent, however, simultaneously donated a somewhat lesser sum to the subsidiary's surplus; the entire transaction was consummated by a simultaneous exchange of checks. The Commissioner imposed the personal holding company surtax on the amount of the subsidiary's payment which represented dividends. The Tax Court affirmed the Commissioner's determination, and in reversing the Court of Appeals stated:

> "The nature of the personal holding company surtax makes it particularly important to determine by reference to the substance of the transaction rather

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[2] This basic issue was pleaded in paragraphs 4(d) and 4(e) of the petition to the Tax Court (R. 3). Nevertheless both the Tax Court and the Court of Appeals (Appendix A, p. 17, footnote 2) erroneously refused to consider petitioner's contention that it served as a mere conduit for the transfer of funds from Highland to Chateau; that it had received no economic benefit from them; and that the advances accordingly were not dividends to it.

[3] Docket No. 27587, 63-1 USTC ¶ 9388.

than its form whether income was in fact received, for here we are not dealing with normal income tax, but with the severe penalty imposed on personal holding companies. . . .

"It would be completely at variance with the purpose of the personal holding company legislation, as demonstrated by these authorities, to uphold the imposition of the tax for failing to distribute accumulated income when, as here, there is no accumulation and no income to distribute. . . ."

The decision below is also in direct conflict with the reasoning of *Knight Newspapers, Inc.* v. *Commissioner*, 143 F. (2d) 1007 (6th Cir. 1944), cited approvingly in *Frelbro*, where the court in its desire to avoid the harshness of the penalty surtax held that a dividend improperly paid to a corporate taxpayer in one year and repaid in a subsequent year was deemed to be impressed with a constructive trust in the year of receipt and hence was not personal holding company income.

The personal holding company surtax is not a revenue measure as such and is therefore not really a tax. It is designed to compel a corporation to distribute its earnings by imposing a confiscatory penalty if the earnings are accumulated. Petitioner in the present case did not accumulate earnings. The payments from Highland were immediately lent to the Chateau venture. (Appendix A, p. 20, footnote 5). The omission, in the opinion of the court below, of any reference to the personal holding company surtax indicates a mistaken classification as dividends of inter-corporate advances shown on the books of Highland and petitioner as loans, a classification which clearly disregarded the purpose of the penalty surtax.[3a]

[3a] If the court below had expressly ruled that the existence of the personal holding company surtax in this case had no effect on the

Although the personal holding company surtax is not a revenue measure, it fills an important role in the administration of the tax laws. The Secretary of the Treasury in a statement made to the House Ways and Means Committee on February 6, 1963 in connection with the President's program of tax reform listed certain recommended steps . . . "to tighten the personal holding company provisions so that high-bracket taxpayers cannot use closely-held corporations to collect ordinary income for purposes of obtaining a more favorable rate of tax".[4]

If the recommended legislative changes are adopted, the number of cases involving this penalty surtax will in all likelihood grow. In the interest of uniformity in the administration of the tax laws and the application of the surtax only to situations which it was designed to cover, this Court should resolve the conflict between the *Frelbro* and *Knight* cases and the decision below.

2. The decision below should be reviewed because it affirms the Tax Court holding that the burden of proof in a case involving the personal holding company surtax is no different from that in a case involving ordinary income tax liability.

Petitioner has been unable to find a decision of a Court of Appeals in which this issue has been expressly considered, but there is a compelling reason why the normal rule that the burden rests on the taxpayer should not apply. The personal holding company surtax is a penalty imposed on a corporation which receives and accumulates certain types of income. A corporation which is in effect accused of this activity should have the right to rely on the fundamental principle that the burden of proving this implied

court's decision, the conflict with *Frelbro* would have been clear. The court's failure even to refer to the penalty surtax, however, makes the conflict more obvious. See footnote 1, supra, p. 5.

[4] Hearings before the Committee on Ways and Means, House of Representatives, Eighty-Eighth Congress, First Session, page 121.

wrongdoing should rest on the accuser, not on the accused. This principle is particularly appropriate in the instant case where the alleged dividends giving rise to the penalty surtax were at most constructive dividends. It has been held that the burden of proving that a taxpayer has received a constructive dividend rests on the Commissioner.[5]

When the Commissioner of Internal Revenue seeks to impose liability for the 50% civil fraud penalty,[6] the statute itself imposes the burden of proof on him.[7] The penalty surtax here is 85% of the income in excess of $2,000.[8] Petitioner submits that this Court should establish the rule that the burden of proving that a taxpayer received and failed to distribute personal holding company income should be imposed on the Commissioner.

3. A third reason for granting the writ in this case lies in the sharp conflict which exists in decisions of the various Courts of Appeal as to the imposition of the burden of proof where a substantial inaccuracy is found in the Commissioner's method of determining tax liability.

The Court below found that the Commissioner had erred in including all the money advanced by Highland for the Chateau project as dividends to petitioner. The Commissioner's notice of deficiency made no distinction between the amounts paid to petitioner and the amounts paid to Wilbur (R. 9), but the court below ruled that the latter payments were not dividends (Appendix A, p. 20). The Commissioner's error was therefore substantial. Despite

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[5] "Whether the taxpayers received a constructive dividend is the principal question. The Tax Court resolved it against the taxpayers upon a determination that the taxpayers had failed to prove that they had not received such a dividend. We think the case must be reversed upon the ground that the Commissioner has failed to prove that they did." *Stout* v. *Commissioner*, 273 F. (2d) 345 (4th Cir. 1959).

[6] Internal Revenue Code of 1954, Sec. 6653(b), 26 U.S.C. 6653(b).

[7] Ibid, Sec. 7454, 26 U.S.C. 7454.

[8] Internal Revenue Code of 1939, Sec. 500.

this ruling the court in effect held that the burden of proving that the remaining payments were not dividends was on petitioner. (Appendix A, p. 48)

This ruling is clearly at variance with decisions of at least two other Courts of Appeal, and in a more recent decision of the First Circuit, *United Aniline Co.* v. *Commissioner*, decided April 25, 1963,[9] Judge Aldrich expressly recognized the conflict. In *United Aniline* the court referred to its decision in the instant case as one involving the burden of proof and then cited cases in the Fourth Circuit, *Stout* v. *Commissioner*, 273 F. (2d) 345 (1959)[10] and the Ninth Circuit, *Clark* v. *Commissioner*, 266 F. (2d) 698 (1959) as decisions which in the court's view erroneously held that the burden of proof rested on the Commissioner if the taxpayer introduced evidence from which it could be found that the Commissioner's determination was erroneous.

Although not cited in *United Aniline* a clear expression of the doctrine which the First Circuit believes to be erroneous is found in *Cohen* v. *Commissioner*, 266 F. (2d) 5, 11 (9th Cir. 1959):

> "When the Commissioner's determination has been shown to be invalid, the Tax Court must redetermine the deficiency. The presumption as to the correctness of the Commissioner's determination is then out of the case. (citation). *The Commissioner and not the taxpayer then has the burden of proving whether any deficiency exists and if so the amount. It is not incumbent upon the taxpayer under these circumstances to prove that he owed no tax or the amount of the tax which he did owe.*" (italics supplied) (citing *Helvering* v. *Taylor*, 293 U.S. 507).

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[9] Docket No. 6060, 63-1 USTC ¶ 9434.

[10] See footnote 3, supra.

The foregoing conflict among the Courts of Appeal as to the imposition of the burden of proof where the Commissioner has committed a substantial error in determining the deficiency obviously raises an important question in the administration of the tax laws.

4. The final reason for granting the writ lies in the conflict which exists in decisions of various Courts of Appeal as to the nature of a ruling by the Tax Court that certain corporate payments constitute dividends. Although the line between a question of fact and a question of law is admittedly a shadowy one, petitioner submits that whether a corporate payment which is clearly not a dividend under corporation law[11] constitutes a dividend for the purposes of taxation is clearly a question of law, or at the minimum is a mixed question of fact and law.

The importance of the distinction lies in the effect to be given to the determination of the Tax Court. If the issue is essentially factual, the Tax Court's conclusion is to be followed unless clearly erroneous. If the question is essentially legal, the Court of Appeals may make an independent determination and substitute its judgment for that of the Tax Court.

In *Spheeris* v. *Commissioner*, 284 F.(2d) 928 (1960) the issue was whether certain withdrawals from a corporation were loans or dividends. The Seventh Circuit held that this was a mixed question of law and fact on which the court could review the legal effect of the primary facts found by the Tax Court. The opinion relied on *Ortmayer* v. *Commissioner*, 265 F.(2d) 848 (7th Cir. 1959) where with reference to a somewhat similar issue the court stated that it was *free to substitute its judgment for that of the* Tax Court.

The Tax Court itself, however, as indicated by its opin-

[11] Appendix A, p. 19, footnote 4.

ion in the present proceedings, believes that the "loans-versus-dividends" issue is a factual one. (R. 122). And the court below apparently agreed with the Tax Court when in accepting that court's determination, it stated: "We cannot say that the Court was plainly wrong." (Appendix A, p. 18) [12]

This Court recently had occasion to consider the "law-versus-fact" issue in *Commissioner* v. *Duberstein*, 363 U.S. 278 (1960). There a majority of the Court held that the question whether certain payments were gifts and hence exempt from income tax was sufficiently factual so that "primary weight . . . must be given to the conclusions of the trier of fact." (363 U.S. at 289). But the Court emphasized the non-technical nature of the question involved. In the present case the issue is whether certain payments regarded by the parties as loans and expressly so designated should be deemed to be dividends for the purposes of income taxation and the personal holding company surtax. The issue thus raised is complex involving among other things questions of the interrelation of corporate law and the law of taxation,[13] the purpose of the personal holding company surtax and the like. Such a question hardly meets the non-technical standard referred to in

[12] In thus approving the Tax Court's decision, the court below stressed the fact that petitioner's surviving directors had not taken any steps after Wilbur's death to treat the advances as loans (Appendix A, pp. 18-19). What occurred after Wilbur's death, however, was completely irrelevant in determining whether the advances were loans. The crucial question in the "loans-versus-dividends" issue is whether there was an intention *at the time the advances were made* that they should be repaid. *Wiese* v. *Commissioner*, 93 F. (2d) 921 (8th Cir. 1938), cert. den. 304 U.S. 562. *Hilton* v. *Caster*, 19 TCM 1090, 1110 (1960). In the present case it was the intention of Wilbur, the dominant principal, that controlled. *E. J. Reschuni*, 29 T.C. 1193, 1203 (1958). Hence what the surviving directors did or did not do after Wilbur's death had no bearing on what his intention was in 1951 and 1952 when the payments from Highland were made.

[13] See Appendix A, p. 19, and footnote 4 on that page.

Duberstein. Whether it be regarded as a question of law or a mixed question of fact and law, it represents an issue on which an appellate court should make an independent determination rather than feel itself bound by a "not plainly wrong" conclusion of the Tax Court.

Since cases involving the legal effect to be given to corporate payments made to stockholders are numerous and recurring, and in light of the conflict among the Courts of Appeal as to the scope of appellate review in such cases, a decision by the Court on this issue would facilitate a more uniform administration of the tax laws.

Conclusion

For the reasons set forth above, it is respectfully submitted that this petition for a writ of certiorari should be granted.

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Appendix A

United States Court of Appeals
For the First Circuit

No. 6018.

GENERAL AGGREGATES CORPORATION,

PETITIONER,

v.

COMMISSIONER OF INTERNAL REVENUE,

RESPONDENT.

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

Before WOODBURY, *Chief Judge*, and HARTIGAN and ALDRICH, *Circuit Judges*.

Bertram H. Loewenberg, with whom *Daniel Needham, Jr.*, *Stephen A. Hopkins*, and *Sherburne, Powers & Needham* were on brief, for petitioner.

Stanton H. Zarrow, Attorney, Department of Justice, with whom *Louis F. Oberdorfer*, Assistant Attorney General, and *Lee A. Jackson* and *Meyer Rothwacks*, Attorneys, Department of Justice, were on brief, for respondent.

OPINION OF THE COURT.

January 31, 1963.

ALDRICH, *Circuit Judge*. This petition to review a decision of the Tax Court raises the single ultimate question of whether the court's finding that taxpayer received certain funds in 1951 and 1952 as dividends was incorrect, in whole or in part. Taxpayer, General Aggregates Corporation, is a Massachusetts corporation, having, at the period in question, 14,941 outstanding shares of Class A (preference) stock and 54,538 shares of Class B (common)

stock. One George S. Wilbur owned 5,395 shares of the Class A stock, the balance being owned by 150 persons unrelated to him. In addition Wilbur owned 14,293 shares of Class B stock. 40,000 shares of Class B were owned by his wife, his son, and his daughter. Highland Sand and Gravel Company, Inc., another Massachusetts corporation, had outstanding 589 shares of Class A (preference) stock, of which 138 shares were owned by Wilbur, 311 shares by his family, and 140 shares by 21 persons unrelated. All of its 10,000 shares of Class B stock were owned by taxpayer. No dividends had been paid by Highland in twenty years, and cumulative arrearages on Class A, by December 31, 1952, were $94,000.[1] During the period in question Highland's accumulated earnings stood in the vicinity of $300,000. Taxpayer's assets, in addition to the Highland stock, on January 1, 1951, consisted essentially of a bank account in the amount of $60,000. Wilbur was the principal executive officer, and one of the three directors, of both companies.

During 1950 Wilbur conceived the notion of establishing a high-class restaurant, and leased certain real estate for that purpose. In May, 1951, he formed a corporation known as Chateau Montserrat, Inc., to operate the business. Prior to, and, again, after Chateau's incorporation he discussed with counsel the proposed ownership of its stock. Under the first plan Wilbur was to own 997 of 1,000 issued shares; under the other 499 shares, with 500 shares to be issued to a Miss Aarons, his former secretary. No shares were actually issued. However, on Chateau's books, kept by Wilbur, the entries show that taxpayer and Miss Aarons *each owned 50 per cent* of the stock. Taxpayer's half was

[1] There is a mystery as to the whereabouts of the "unrelated" Class A stockholders. The uncontroverted evidence was that all corporate notices mailed to them were returned marked "address unknown." However, no one disputes that this stock was validly issued and outstanding.

paid for, in the amount of $5,000, by taxpayer, from its accumulated funds. Miss Aaron's was paid for by $3,500 similarly supplied by taxpayer and charged to Wilbur, and by $1,500 in corporate expenses allegedly paid by her. At the trial Miss Aarons testified to no such expenditures, said that she did not know she was a stockholder, and stated, in which she was corroborated by another witness, that Wilbur told her that he "would give [her] some shares" if the business was successful (which it never was).

Establishing the restaurant as a going concern eventually required the expenditure of $158,000 in addition to what had been paid in for the stock. In round numbers, $40,000 came from taxpayer's funds on hand on January 1, 1951; $90,000 came from taxpayer from funds received during 1951 and 1952 from Highland, and $28,000 came from Wilbur from moneys paid to him by Highland, and charged to his account, but thereafter charged on Highland's books (but not on taxpayer's) as payments to taxpayer. Some of all of these payments were made directly to Chateau; others were made to persons who had supplied labor or materials to Chateau. Wilbur entered all payments, in one manner or another, on the corporate books of taxpayer and/or Highland. Some entries, in addition to those already mentioned, he afterwards changed. It is impossible to find any consistent pattern, either in the original entries or in the changes. Only one thing is clear. No payment was ever denominated on the books as a dividend from Highland. The Commissioner, however, took the position that every payment originating from Highland was a dividend to taxpayer. The Tax Court agreed.

We, of course, recognize our obligation to accept all findings of the court supported by evidence. We accept the finding that taxpayer owned one half of Chateau's stock. The court did not state who owned the other half, except

to say that it did not belong to Highland. This negative we also accept.[2] We do not find, in the court's opinion or otherwise, the "implication" that the government would have us draw that the court found that Wilbur did not beneficially own this other half. However, for present purposes we do not see that it makes any difference whether Miss Aarons owned it, in whole or in part, in her own right, or whether she was named as a straw for Wilbur.

The restaurant opened but was not a success. In November, 1952, Wilbur died. In January, 1953, Chateau was liquidated, realizing $1,400 over and above outstanding bills, other than the aforesaid advances or expenditures of $158,000 to the extent that these were obligations. This small balance was paid to Wilbur's estate, an event to which we attach no legal significance.

Most of the tax court's opinion is devoted to a recitation of the above and other, consistent, facts. The court, determining that the advances to taxpayer from Highland were not loans, concluded that they were taxable dividends. It based this on a finding that Wilbur did not intend that they should be repaid. This matter we will return to. It further determined that all payments made to Wilbur by Highland and by him applied to Chateau were also dividends to taxpayer because, through its stock interest, they accrued to taxpayer's "benefit." How it deduced this it did not state. On the court's own findings taxpayer owned

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[2] The only basis under which it could be said that the beneficial ownership was in Highland would be to find that taxpayer was simply a conduit used by Wilbur for a misappropriation of Highland's money, and hence did not legally receive it. *Cf. Newell* v. *Hadley*, 1910, 206 Mass. 335. The court did not so find, and it was not compelled so to find, particularly in view of the fact that taxpayer had already become a part owner of Chateau with what, unquestionably, was its own money. Furthermore, although in argument taxpayer spoke of itself as a conduit, the pleadings do not proceed on this basis, but allege that taxpayer received the funds from Highland as "loans" rather than alleging that it did not receive them at all.

only a half interest in Chateau. Therefore on the basis of receipt from Highland (rather than from Wilbur, a very considerable assumption[3]) or, more exactly, of constructive receipt, which, although not articulated, is the principle most favorable to its position, *Greenspon* v. *Commissioner*, 8 Cir., 1956, 229 F.2d 947, the court should have charged taxpayer with only one half of these payments. *Cf. Shunk* v. *Commissioner*, 6 Cir., 1949, 173 F.2d 747. Moreover, if the payments were loans, a matter we will consider later, the "benefit" to taxpayer was not even that. Wilbur's reversing the book entries of the payments made, and previously shown to have been made, to him to appear to charge them to taxpayer could not alter the plain facts, a ruling the court was quick to make with respect to other entries. The court did not, in fact, purport to rely on this reversal.

We revert to the payments made directly to taxpayer which went from it either to Chateau's suppliers or to Chateau. The burden of proving that these were loans to taxpayer is on taxpayer. *Allen* v. *Commissioner*, 1 Cir., 1941, 117 F.2d 364; *Tate* v. *Commissioner*, 8 Cir., 1938, 97 F.2d 658, *cert. den.* 305 U.S. 639; *cf. Hague Estate* v. *Commissioner*, 2 Cir., 1943, 132 F.2d 775, *cert. den.* 318 U.S. 787. We cannot say that the Court was plainly wrong. Significant to us is the fact that if these payments were loans taxpayer has not treated them as such in any substantial manner since they came to the knowledge of its

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[3] Even a constructive dividend must be paid by and received from the declaring company, not from someone else with that other person's money. The court could rule that these payments were dividends to taxpayer only by finding that Wilbur did not own the funds Highland paid to him and charged to his account. It would seem inconsistent to say that Wilbur merely acted as Highland's agent to transfer its funds into Chateau, and at the same time say that taxpayer, in doing exactly the same thing, was not an agent, but acted on its own account.

remaining directors in 1953.[4] If taxpayer could show, which we do not think it has, that they were loans to be repaid only if the Chateau venture was successful, we would rule that such favorable, interest-free advances to a stockholder, for the benefit of the stockholder, cannot go tax-free. *Cf. Trinchera Timber Co.*, 1928, 13 B.T.A. 934.

Taxpayer calls attention to the fact that there was no right to pay dividends on Highland's Class B stock while the Class A was in arrears. There are two answers to this. In the first place, funds remained in Highland that were apparently ample to protect the interests of the Class A stockholders. More important, a number of courts have ruled that disproportionate payment of dividends does not alter the fact of their receipt. *Spheeris* v. *Commissioner*, 7 Cir., 1960, 284 F.2d 928, *cert. den.* 366 U.S. 944; *Roschuni* v. *Commissioner*, 5 Cir., 1959, 271 F.2d 267, *cert. den.* 362 U.S. 988, *aff'g E. J. Roschuni*, 1958, 29 T.C. 1193; *Lincoln National Bank* v. *Burnet*, D.C. Cir., 1933, 63 F.2d 131. This seems to us correct as a matter of policy, at least after the "related" stockholders had passed their opportunity to disaffirm. Indeed, even if it could be said that the other stockholders were defrauded, this does not mean that income was not realized. *St. Regis Paper Co.* v. *Higgins*, 2 Cir., 1946, 157 F.2d 884, *cert. den.* 330 U.S. 843; *cf. James* v. *United States*, 1961, 366 U.S. 213.

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[4] Alternatively, the surviving directors might have been able to take the position that, if dividends, they were unauthorized. Acting alone Wilbur was but a minority member of Highland's board of directors. In case of payments made to sole stockholders such formalities may be overlooked. Wilbur, however, was not the stockholder; taxpayer was. Wilbur was only a minority stockholder, as well as but a minority director, of taxpayer. It is difficult to see how he could lawfully, in any capacity, cause Highland to declare a dividend. However, here again, there was a burden on the parties, upon learning of the circumstances, to take action. It is no answer that a number of these payments made to taxpayer were shown by Wilbur's later book entries, unsubstantiated in fact, to have been paid back.

There remains the question of Highland's payments initially made to Wilbur rather than to taxpayer. Wilbur did not advance all of these directly to Chateau, but in some instances paid for labor and material furnished for its account. Even though, like many other matters, such payments do not appear on Chateau's books, we do not think that this meant that they were outright gifts to Chateau as distinguished from loans.[5] Looking at the substance of the transaction it seems fairly apparent (it is not possible to be certain about anything that was in Wilbur's mind) that Wilbur did not want one half of his advances to accrue to the permanent benefit of Chateau, and hence to taxpayer, particularly as this would mean that they could later be recovered from Chateau only by virtue of a taxable transaction. He would feel the same way about the other half if this was beneficially his rather than Miss Aarons'. Having in mind the tenuousness of Miss Aaron's interest in any event, we greatly doubt that he was making her a further gift. Accordingly, we conclude that Wilbur's advances to Chateau were intended as loans. As we have said previously, the Court's treating these payments as dividends constructively received by taxpayer in their entirety was necessarily wrong. We conclude it would be wrong even to split them fifty-fifty.

Judgment will be entered setting aside the decision of the Tax Court and remanding the action for the entry of a new decision consistent herewith.

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[5] The same question arises with respect to taxpayer. We can hardly believe that taxpayer was making outright gifts to Chateau. This would be a poor way to do business with even a partially-owned subsidiary.

Appendix B

UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

No. 6018.

GENERAL AGGREGATES CORPORATION,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

JUDGMENT

January 31, 1963

This cause came on to be heard on petition for review of a decision of the Tax Court of the United States and was argued by counsel.

Upon consideration whereof, It is now here ordered, adjudged and decreed as follows: The decision of the Tax Court is set aside and the action is remanded for the entry of a new decision consistent with the opinion filed this day.

By the Court:

ROGER A. STINCHFIELD, Clerk

By: (s) DANA H. GALLUP,
Chief Deputy Clerk

Appendix C

Internal Revenue Code of 1939

Sec. 500. Surtax on Personal Holding Companies.

There shall be levied, collected, and paid, for each taxable year beginning after December 31, 1938, upon the undistributed subchapter A net income of every personal holding company (in addition to the taxes imposed by Chapter 1) a surtax equal to the sum of the following:

(1) 75 per centum of the amount thereof not in excess of $2,000; plus

(2) 85 per centum of the amount thereof in excess of $2,000.

Sec. 501. Definition of Personal Holding Company.

(a) General Rule.—For the purposes of this subchapter and chapter 1, the term "personal holding company" means any corporation if—

(1) Gross Income Requirement.—At least 80 per centum of its gross income for the taxable year is personal holding company income as defined in section 502

Sec. 502. Personal Holding Company Income.

For the purposes of this subchapter the term "personal holding company income" means the portion of the gross income which consists of:

(a) Dividends, interest (other than interest constituting rent as defined in subsection (g)), royalties (other than mineral, oil, or gas royalties), annuities.

. . . . . .

In the Supreme Court of the United States

OCTOBER TERM, 1963

No. 142

GENERAL AGGREGATES CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 110-126)[1] are unreported. The opinion of the court of appeals (Pet. 14-20) is reported at 313 F. 2d 25.

JURISDICTION

The judgment of the court of appeals was entered on January 31, 1963. (Pet. 21.) A petition

[1] Record references are to the record appendix to the taxpayer's brief in the court of appeals.

for rehearing was denied on February 19, 1963. (Pet. 2.) The petition for a writ of certiorari was filed on May 18, 1963. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the courts below correctly sustained the Commissioner's determination that certain funds received by the taxpayer from another corporation in which it was a stockholder should be treated as dividends and not as loans.

STATUTE AND REGULATIONS

Internal Revenue Code of 1939 (26 U.S.C., 1952 ed.):

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) [as amended by the Act of June 25, 1947 (P.L. 113), c. 144, 61 Stat. 179] *Definition of Dividend.*—The term "dividend" when used in this chapter * * * means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made. In the case of a corporation which, under the law applicable to the taxable year

in which the distribution is made, is a personal holding company, * * * such term also means any distribution (whether or not a dividend as defined in the preceding sentence) to its shareholders, whether in money or in other property, to the extent of its subchapter A net income, * * *

* * * * *

SEC. 500. SURTAX ON PERSONAL HOLDING COMPANIES [as amended by Sec. 181 of the Revenue Act of 1942, c. 619, 56 Stat. 798].

There shall be levied, collected, and paid, for each taxable year beginning after December 31, 1938, upon the undistributed subchapter A net income of every personal holding company (in addition to the taxes imposed by chapter 1) a surtax equal to the sum of the following:

(1) 75 per centum of the amount thereof not in excess of $2,000; plus

(2) 85 per centum of the amount thereof in excess of $2,000.

SEC. 501. DEFINITION OF PERSONAL HOLDING COMPANY.

(a) *General Rule.*—For the purposes of this subchapter and chapter 1, the term "personal holding company" means any corporation if—

(1) *Gross income requirement.*—At least 80 per centum of its gross income for the taxable year is personal holding company income as defined in section 502 * * *

(2) *Stock ownership requirement.* — At any time during the last half of the taxable year more than 50 per centum in value

of its outstanding stock is owned, directly or indirectly, by or for not more than five individuals.

* * * *

SEC. 502. PERSONAL HOLDING COMPANY INCOME.

For the purposes of this subchapter the term "personal holding company income" means the portion of the gross income which consists of:

(a) Dividends, interest (other than interest constituting rent as defined in subsection (g)), royalties (other than mineral, oil, or gas royalties), annuities.

* * * *

Treasury Regulations 118 (1939 Code):

SEC. 39.502-1 *Personal holding company income.* The term "personal holding company income" means the portion of the gross income which consists of the following:

(a) *Dividends.* The term "dividends" includes dividends as defined in section 115(a), * * *

* * * *

STATEMENT

Taxpayer, General Aggregates Corporation, is a Massachusetts corporation. In the taxable years 1951 and 1952 it was concededly a personal holding company dominated by one George S. Wilbur (now deceased) who with members of his family owned and controlled more than 50 per centum in value of the outstanding stock of the company. The Wilbur fami-

ly also dominated another Massachusetts corporation, Highland Sand and Gravel Company, Inc. (hereinafter called Highland), and taxpayer owned all of the Class B (common) stock of that company. (R. 111-112; Pet. 5, 14-15.)

Highland had $311,000 [2] in earnings and profits at the end of 1951 and $293,000 at the end of 1952. From 1932 to 1952, inclusive, Highland paid no formal dividends to its stockholders. (R. 119-120; Pet. 15.)

In 1950 Wilbur decided to establish a restaurant and in 1951 he organized a corporation, Chateau Montserrat, Inc. (hereafter called Chateau), to conduct the business. Taxpayer owned and paid for one-half of Chateau's stock and on the books of Chateau Wilbur's secretary was shown as owner of the other one-half. (R. 112-113; Pet. 15-16.)

In order to provide funds to establish the restaurant as a going business, various amounts were paid by Highland to taxpayer and Wilbur in 1951 and 1952, which they used for this restaurant project. In this connection, Highland paid a total of $126,000 ($98,000 to taxpayer and $28,000 to Wilbur) of which $89,000 was paid in 1951 and $37,000 in 1952. (R. 122; Pet. 5, 16.)

The Commissioner of Internal Revenue determined that these amounts of $89,000 and $37,000, ostensibly representing loans, constituted income from dividends within the scope of § 115(a) of the Internal

[2] Round amounts are used for convenience.

Revenue Code of 1939;[3] and that taxpayer met the stock ownership and income requirements of § 501 (a) of the Code in each of the years and was, accordingly, liable under § 500 for the surtax on personal holding companies. (R. 9, 121.)

The Tax Court sustained the Commissioner and held that the payments were dividends and not loans to taxpayer. (R. 126.) The court of appeals affirmed as to the payments made directly to taxpayer, but reversed as to the payments initially made to Wilbur. (Pet. 18-20.)

ARGUMENT

The decision below is correct and none of the four grounds for certiorari advanced by petitioner warrants further review by this Court.

1. The assertion of a conflict with *Frelbro Corp. v. Commissioner*, 315 F. 2d 784 (C.A. 2) (Pet. 6-8), is unsupportable. The court there held that a simultaneous exchange of checks between a parent and subsidiary was a dividend from the subsidiary to the parent only of the difference between the two checks, a decision having no parallel here. In so holding, the court observed that the heavy personal holding company surtax that turned upon its resolution of the question made it "particularly important" that the "substance of the transaction rather than its form" be looked to (315 F. 2d at 784). The conflict

[3] It was the Commissioner's position with regard to the sums paid to Wilbur that they were constructive dividends to taxpayer inasmuch as they were invested in Chateau in which taxpayer owned stock but Wilbur did not.

claimed is that the court below did not similarly note its awareness of the "particular importance", because of the heavy surtax, of looking to substance rather than form. Whether the omission reflects a difference of attitude or only of writing style need not be debated; in neither event does it rise to a conflict of principle, much less to a conflict of decisions.

2. On its claim that the burden of proof should be on the Commissioner in personal holding company cases (Pet. 8-9), petitioner alleges no conflict. And in the absence of a special statute shifting the burden (*e.g.*, as on the issue of fraud, § 1112 of the 1939 Code), there is no basis for a different rule in such cases.

3. The court of appeals upheld the Commissioner's determination that the amounts paid by Highland directly to petitioner were dividends to it but held that the amounts paid to Wilbur were not. Petitioner claims that the Commissioner's error in characterizing Wilbur's receipts shifts the burden of proof to the Commissioner as to the character of petitioner's receipts (Pet. 9-11). The cases cited as being in conflict, whatever their merits, involve only the burden of proving the amount of a receipt or expenditure after the Commissioner's determination as to that item has been shown erroneous; they in no way suggest that an error as to the treatment of one item (Wilbur's receipts) shifts the burden of proof on another (petitioner's receipts).

4. The Tax Court based its characterization of the payments from Highland to petitioner as dividends

rather than loans on its finding that the parties (in reality, Wilbur, the controlling figure in both corporations) did not intend that they be repaid (R. 122-126). That finding of fact, amply supported by the evidence, was properly affirmed by the court of appeals as not being plainly wrong (Pet. 17, 18-19). Whatever the language in *Spheeris* v. *Commissioner*, 284 F. 2d 928 (C.A. 7), certiorari denied, 366 U.S. 944, referring to "mixed questions of law and fact" may imply as to the proper scope of review in such cases, the court there likewise affirmed the trial court's conclusion that the payments involved were dividends rather than loans, and the decision accordingly cannot be in conflict (see Pet. 11) with the decision below.

CONCLUSION

For the reasons stated, the petition for certiorari should be denied.

Respectfully submitted.

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JULY 1963.

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